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Finance for Europe

Consultation response

ECB Guide on the supervisory approach to consolidation in the banking sector

1 October 2020

The Association for Financial Markets in Europe (AFME) welcomes the publication of the ECB's draft **Guide on the supervisory approach to consolidation in the banking sector (hereafter "the guide")** and appreciates the ECB's engagement efforts which have accompanied the public consultation.

Supervisory authorities cannot be, and are not, the drivers of business combination decisions, which must ultimately rely on market forces and the fundamental economics underlying possible transactions. Nevertheless, supervisors do have a role to play, within the context of their mandate, to facilitate the completion of sound, robust business combination projects and AFME very much welcomes the ECB clarifying via this guide how it intends to enable this in practice.

We consider this to be particularly important in the context of the Eurozone banking sector where sectoral overcapacity and low profitability continue to present significant challenges. M&As, both domestic and cross-border, while not a silver bullet, undoubtedly have an important role to play in addressing these challenges.

We are grateful therefore to have the opportunity to provide our comments on the guide. Before setting out our suggestions for further developing the ECB's approach to M&A transactions in the guide in Section III, our response begins in Sections I and II by briefly recalling the remaining fundamental obstacles to M&A transactions, and cross-border transactions in particular[1], which originate from EU prudential regulation, as well as from other areas of legislation, at national and European levels.

We understand that these issues are not within the direct remit of the ECB nor are they strictly speaking within the scope of the present consultation. Nevertheless, we consider it is important to recall their existence as they continue to act as significant practical impediments to business combinations.

In this context, we reiterate our strong support for the ECB to continue calling on the EU co-legislators to overcome these obstacles. We also invite the ECB to actively participate in the identification and resolution of issues which may require legislative change. To this end, and to the extent the ECB considers that further consolidation in the European banking sector may be desirable, we encourage it to take a pragmatic approach to the evaluation of the consolidation projects, and to make full use of its existing powers granted under EU regulation.

[1] Given the international nature of our members' businesses, our response focuses on cross-border transactions, although many of the issues we raise can also be valid in a domestic context

Regulatory change notwithstanding, we believe that the ECB could, within its existing powers, further assist business combinations by:

- Deploying flexibility to allow post-combination capital restructuring to avoid minority interest haircuts which can be significant
- Coordinating across NCAs and NDAs to avoid national-level capital requirements being imposed at levels which would be inconsistent with the risk-profile of Banking Union groups
- Acting as a single-entry point and guide to obtaining all necessary authorisations within as short a timeframe as possible
- Developing its approach to cross-border LCR and NSFR waivers in line with current regulatory framework as soon as possible based on engagement with SSM-supervised entities on their practical experience and impacts of such waivers
- Clarifying its distribution recommendation policy and referring to the applicable policy in the guide

Section I. Obstacles to cross-border M&A resulting from the existing EU prudential framework

The EU prudential framework, and its national implementations, contain regulatory obstacles to the cross-border flow of capital and funds within banking groups which constitute an ongoing barrier to cross-border consolidation in the Euro Area.

These include:

- **Absence of meaningful cross-border waivers in the Eurozone**: In spite of the existing ECB policy with respect to cross-border LCR waivers, it is well acknowledged[2] that this has been of limited benefit in practice: no such waivers have been granted and the ECB's existing policy itself is limited to 75% of the HQLA requirement at the parent level, with the review of this approach announced for 2018 not yet having taken place. Moreover, at this stage, there is no clarity on the cross-border waiver policy that will be adopted for the CRR2 NSFR requirement. We encourage the ECB to update and publish its approach to cross-border liquidity waivers in line with current regulatory framework as soon as possible. We recognise that the situation is exacerbated by the complex approach to large exposure exemptions across the eurozone, which continues to create an unlevel playing field and, in some cases where such limits are applied via national law, acts as a direct impediment to the cross-border flow of funds. In the EU, internal MREL requirements also apply at the level of all subsidiaries and cannot be waived across Member States, even if these entities are not material subgroups and are all within the scope of a single resolution authority, i.e. the SRB in the case of the Banking Union. This EU application goes beyond the internationally agreed TLAC standard. Finally, we recall that cross-border waivers for capital are also not available.

[2] See for instance the ECB's Financial Integration in Europe Report, May 2018

- **Restrictions on distributions of excess capital:** certain national laws/regulations do not allow the free movement of capital across Eurozone countries, even within the same group e.g. limits placed on the distribution of the excess capital from subsidiaries to the parent company.

- **Non-recognition of the Banking Union in G-SIB/G-SII scores:** Intra-Eurozone assets and liabilities contribute to the cross-border activity indicator of the international G-SIB buffer requirement, penalising cross-border institutions within the Eurozone in spite of progress made via the EU recovery & resolution framework and the reinforcement of group supervision under the SSM. While the additional EU methodology introduced via the CRD5 provides the possibility to exclude such assets and liabilities from the cross-border component, AFME has significant reservations with the approach proposed by the EBA in its recent consultation[3] on this topic and it remains to be seen whether Competent or Designated authorities will in practice be able to reduce the EU additional score or resulting G-SII bucket allocation.

- **Lack of predictable DSII buffers:** Although the D-SII methodology is established via EBA Guidelines, it lacks predictability in practice, in particular with respect to the allocation of scores and buckets and could benefit from more alignment with the G-SII buffer framework.

- **Restrictions in the recognition of minority interests in group capital:** The CRR restricts the inclusion of the minority interests (located in CET1, AT1 or T2) in the calculation of consolidated own funds, as the surplus capital pertaining to minorities is excluded from the calculation, whilst on the asset side partially-owned subsidiaries are fully consolidated at group level. Hence the mere fact of performing an acquisition destroys the prudential excess capital of the new subsidiary in this context, even though this excess capital remains available to the banking sector from an economic point of view. As the level of capitalisation of subsidiaries is often higher than minimum requirements, and because it not possible to recognise this excess at group level, the current regulation creates a significant disincentive to M&A transactions with minority interests. We provide suggestions below as to how the ECB might exercise supervisory flexibility to help overcome this in appropriate situations.

- **CRR "10%/15% thresholds" and deduction of significant investments in financial sector entities:** The current CRR treatment of investments in the capital of financial sector entities that are outside the scope of prudential consolidation requires the deduction of any amounts exceeding 10% of the bank's "relevant CET1" capital. While we understand the policy concerns potentially associated with cross-holding schemes designed to artificially inflate banks' capital positions, this treatment is very conservative and can act as real impediment to banking consolidation. Even if it is associated with investments which do not fall under the prudential consolidation perimeter, amending this deduction could enable "step-up acquisitions" (i.e. a business combination in which a bank obtains control over a target through multiple transactions) and pave the way for future transactions and consolidation.

[3] EBA CP/2020/03

- **Deferred Tax Assets (DTAs) and Deferred Tax Liabilities (DTLs):** The impact on regulatory capital of tax assets depends on their nature and, in the case of DTAs, whether they arise from temporary differences and rely on future profitability. The amount of DTAs that a bank discloses in its balance sheet differs from the amount of DTAs which serve as a basis for the calculation deductions from regulatory capital. The key difference relates to the offsetting benefits between DTAs and DTLs under which, for regulatory capital purposes, the amount of DTAs to be taken into account is independent of any netting allowed by the accounting framework (IAS 12 or national GAAP). Nevertheless, under the CRR some netting adjustments (i.e. DTAs calculated net of DTLs) are allowed under certain criteria, in particular when the DTAs and DTLs relate to taxes levied by the same taxation authority and on the same taxable entity (CRR Art 38.3). We hold the view that such a provision hinders banking consolidation, especially on a cross-border basis, as it prevents banks from taking full advantage of tax optimization opportunities across legal entities. DTAs could play an important role if banks would be allowed to, for example, use tax losses carried forward of acquired banks or net any excess of DTLS generated by profitable subsidiaries/legal entities against excess DTAs generated by other subsidiaries/legal entities. We are aware that this request would entail Level 1 changes, but we would welcome any move from the ECB in this direction, endorsing the proposal.

- **Appropriately balancing operational resilience with the benefits of cross-border groups:** As recognised in the guide, expected efficiency gains can be a key driver of consolidation, including scale benefits in IT and operations. At the same time, operational resilience is key in mitigating risks associated with a cross-border group. However, resilience cannot mean that each local unit should operate in full isolation. We would urge the ECB to look into local initiatives such as the Finnish Preparedness Obligation to ensure that cross-border barriers are unintentionally not being built up, particularly within the Banking Union where the ECB SSM is the single supervisor, as this can erase scale benefits and result in demergers rather than mergers. We take this opportunity to recall that this should apply also with respect to the ECB's supervision of entities belonging to 3rd country groups.

Section II. Obstacles to M&A arising from other legal or regulatory requirements

As the ECB is well aware, regulatory obstacles to business combinations also originate outside of the prudential framework. Our members have highlighted the following examples as having created particular difficulties in the context of past experiences:

- In general, in the EU, M&A transactions are facilitated by the universal succession regime applied to mergers, demergers and other corporate transactions. However, in some jurisdictions **the direct universal succession from one corporate entity to another is not always automatically permitted.** For example, a cross-border demerger is not explicitly ruled yet in many jurisdictions and thus a similar goal has to be achieved through more complex structures and burdensome processes (e.g. local demerger into a dedicated domestic "newco", which could need a new banking license, and subsequent cross-border merger of the "newco" into another foreign company). More standardised requirements among European countries for cross-border transactions would reduce the complexity and uncertainty originated by the differences in the local legal and prudential requirements.

- Another issue which weighs on cross-border consolidation is **the difference in tax regimes between Member States.** The tax framework is particularly relevant for M&A transactions: in any cross-border transaction, deferred tax assets could be lost (depending on the transaction structure), even if there is no change in the parent company's head quarter (see also above). An additional tax inefficiency could be represented by taxes triggered by a change of control not only in case of takeover, but also in case of a merger/combination (for example, in Germany in case of a change of control, the acquirer would be required to pay the real estate transfer tax (RETT)).

- The **AML framework** in its current directive-format, leaves too much discretion to local regulation, creating an uneven pattern of rules across Europe. This creates both inefficiencies for institutions operating cross-border and opens up vulnerabilities in the joint effort in combatting financial crime. The ECB's support for the EU action plan on AML, improving harmonization, is therefore very welcome.

Section III. Comments on the draft guide

A Suggestions for clarifications or changes

1. Proportionality in the context of this guide

The draft guide recalls the proportionality principle in general terms. Our understanding from the ECB's 30 July stakeholder engagement call on the guide is that the ECB's assessment approach will depend on the content of the project (the so called "case-by-case basis"), with which we agree. We would welcome clarification of this in the guide. For instance, the ECB could clarify that, depending on whether the project only marginally changes the situation of the acquiring entity or is more significant and ambitious (for example by changing the nature and the perspective of the business model), the ECB would act accordingly in its approach.

For instance, the level of detail expected on the strategy and the business plan should consider national law and the proportionality principle (section 2.1 of the Guide). Indeed, pursuant to the proportionality principle (as set out in JC/GL/2016/01), and depending on national transpositions, less information may be necessary in a case of change of qualifying holding not resulting in a change of control (i.e. depending on the likely influence the proposed acquirer may exercise on the target).

Moreover, in the context of a combination between entities under direct ECB supervision, it would also be helpful if the guide could highlight that the ECB's assessment will leverage on the existing information it has as a result of this supervision.

Finally, given that the ECB will already have a good understanding of the business models and risk profiles of the entities involved, it would seem more appropriate and more proportionate for the emphasis of the assessment to be on the added value of the proposed project. For this same reason, it should be mentioned in the Guide that the ECB will rely on its existing supervision on individual basis in the context of a M&A transactions in order to avoid additional administrative burdens when related to M&A notifications (such as those related to fit and proper considerations). This should also include cooperation with other EU and non-EU supervisors as we explain further below.

2. **Early communication and integration plan [section 1.2.1, paragraphs 8 and 9]**

The draft guide does not give any specific guidance on the relationship between the Market Abuse Regulation, or specific national legal requirements (such as consultation obligations of worker councils, etc.), or the information to be provided in the early communication phase to the ECB for a preliminary assessment. Nevertheless, past experiences of our members are that obstacles in information sharing with competent authorities do arise in such cases. We would therefore welcome more specific guidance on this matter, and also with respect to other obstacles which may arise when sharing information with the ECB regarding resolution requirements or so-called "non-disclosed" information.

The invitation to the parties involved in a transaction to liaise with the ECB as soon as possible, and its commitment to provide preliminary feedback on the project in a timely manner, are of course welcome. However, parties may not always be able to provide a "robust, credible and informative […] integration plan" at this stage of the process as some information may only be available towards the end of the parties' negotiations. Parties are likely to want to provide the ECB with as early notice as possible, in order to obtain its feedback on the preliminary plan and its guidance on the interactions required with the ECB and other NCAs, as this will inform the transaction timeline (and, in turn, the fully fledged integration plan itself). More detailed and involved information required by the ECB can be provided during the application phase. We would therefore welcome recognition of the likely iterative nature of the early communication process in the guide.

For legal reasons, we would like to ensure that that the guide does not inadvertently create any obligation to formally inform the ECB in cases where neither national law nor EU regulation provide for such an obligation to do so, nor require a decision from the ECB or an NCA. Therefore, for the avoidance of any doubt, in §8, section 1.2.1 "Early Communication", the words "*including on whether or not a formal decision to approve the transaction will be required*" should be deleted.

3. **Sustainability of business model – group-wide business plan [section 2.1, paragraph 15]**

We assume that the term "group" in this context of the group-wide business plan refers to the highest level of consolidation of entities under direct ECB supervision and would welcome a clarification in the guide of whether this is the case or not.

4. **Principles for determining ex post merger P2R & P2G [section 3.2, paragraphs 26 and 27]**

While we fully appreciate that each assessment will be done on a case-by-case basis, if the objectives underlying this guide are to be achieved, we encourage the ECB to go further and develop a more explicit policy stance on possible downward adjustments to the ex post P2.

We very much welcome the principle in paragraph 26 that consideration will be given to the likely asymmetry in timing of costs (usually upfront) and benefits (overtime) of a transaction when the ECB is assessing the so-called "ex post" P2R and P2G. Nevertheless, we consider that the ECB should go further in explaining how this principle will be applied in practice, particularly as this is not fully apparent in the following paragraph 27 describing the P2 starting point and its adjustments. The ECB could specify in paragraph 27 that it will adjust P2 to reflect the frontloading of costs usually involved in a business combination. We note that this would put restructurings resulting from an external acquisition on par with internal restructurings where costs and benefits are recognised in a more synchronised manner.

We would also suggest the ECB give explicit consideration to synergies embedded in the transaction as a key element when determining P2R "downward adjustments". While business combinations need a reasonable period of time before unlocking their full potential, we would like the ECB to differentiate between “top-line” and cost synergies. While the former could be perceived, to some extent as being less certain, previous transactions have shown that costs synergies are reasonably certain and, in some cases, "realised" cost synergies can even exceed the expected synergies at the date of the announcement of the transaction. The ECB could liaise with those Supervised Entities which have been involved in M&A transactions in the past few years to further investigate the extent to which costs synergies have been effectively exploited.

5. **Specify the calculation of the P2R & P2G starting point [section 3.2, paragraph 27, first bullet]**

AFME very much welcomes the clarity provided by the ECB as to the starting point of the assessment of the ex post P2R/P2G of the combined entity. To completely avoid any ambiguity going forward, we suggest that paragraph 27 be amended to specify that the starting point of the P2R/P2G calculation of the combined entity will be the P2R/P2G expressed in percentages and weighted by the respective RWAs of the relevant entities, resulting in an absolute amount for the combined entity which does not exceed the sum of the absolute amounts applicable to the two entities prior to the consolidation.

6. **Reasons for adjusting the P2R/P2G starting point [section 3.2, paragraph 27, second bullet]**

We understand that the guide cannot provide exhaustive lists of examples. However, including further examples in the second bullet point of paragraph 27 of situations likely to result in a downward adjustment could be helpful in clarifying the policy stance. The ECB could consider acknowledging the following types of examples in the guide:

- The benefits of risk diversification arising from a broader coverage of sectors, products and geographies
- Plans to adjust provisioning levels so that the coverage level of the new entity corresponds to the highest level of coverage of the previously independent institutions, thereby homogenising coverage criteria
- Given that the assets of the of absorbed entity are valued at fair value as a result of the merger, in current circumstances this may well result in a downward adjustment compared to their amortised-cost measurement, and therefore a more conservative profile
- To the extent that it must book restructuring costs upfront, the new combined entity has a greater capacity to generate revenues and capital going forward
- The relative certitude of cost synergies compared to “top-line” synergies as noted above and as illustrated in the following numerical example:

	Bank A	Bank B	Combined
RWAs	10,000	20,000	30,000
P2R	1.5%	2.0%	1.8%
P2R (amount)	150	400	550
Operating costs	180	360	540
Costs synergies (hp. 20% combined costs)			108
Integration costs (hp. 1.5x planned savings)			162
Ex post P2R			280

Additionally, some of the examples of possible upward adjustments in this paragraph of the guide also require refinement in our view in order to avoid conveying the wrong impression to the reader. For instance, the reference in paragraph 27 to "complex IT projects" is too general as most banks are likely to have complex IT infrastructure. Further, as written, the guide could be construed as implying that any IT risk integration project would be deemed by the ECB to be "complex" and consequently this would always result in an upwards adjustment of the starting point. The guide should explicitly recognise that this is not the case by also referencing factors which the ECB assessment will also take into account such as the relative size of the acquired entity compared to the acquirer, the complexity of the IT integration project for the acquirer given its track record on IT systems integrations and any actions it would set out in the integration plan to mitigate IT integration risk (see also our general point on proportionality above).

7. Implementation of the ex post P2R and P2G [section 3.2, paragraph 28]

To the extent possible, it would be worthwhile expanding on what is intended by the phrase "determination of the ex post capital requirements and guidance should be clarified during the application process" in this paragraph. We interpret this as the issuance of a SREP decision for the new entity as part of the overall process, which will result in a stable P2R and P2G for at least a year, all else being equal.

Where the merits of the project would justify this, the ECB may also wish to consider a somewhat longer time-frame than 1 year for providing visibility on the future evolution of P2R and P2G of the new entity or phasing in compliance with the ex-post P2R and P2G over a number of years. This would of course be strictly monitored, and adjustments could be made depending on the evolution of the risk profile and performance of the combined entity.

Finally, we consider that, as the single supervisor for Eurozone SIs, the ECB should take the opportunity issuing a new SREP decision for the combined entity to examine whether there is a case for P2R and PRG applying only at the highest level of consolidation of the group in question, particularly where entities withing the Banking Union are involved.

8. **"Use" of badwill [section 3.3, paragraphs 32-33]**

We welcome the confirmation of the principle that the ECB will recognise duly verified accounting badwill from a prudential perspective. However, we consider that the reference in paragraph 32 to expecting badwill to be used to increase the sustainability of the business model of the combined entity for instance by increasing the provisioning for non-performing loans or to cover transaction or integration costs, could benefit from some redrafting to avoid any misunderstandings on the ECB's stance. NPL impairment or provisions to cover integration costs cannot be accounted for in order to "use" accounting badwill; they are accounted for in order to faithfully represent the financial situation of an entity according to the prevailing accounting standards. Moreover, to determine the accounting value of badwill, the entire balance sheet, including the loan portfolio, is remeasured at fair value, which is an exit price. Under IFRS, this remeasurement does not leave space for "increasing the provisioning on non-performing loans" as this paragraph might suggest.

Paragraph 32 also indicates that "badwill distribution" will not occur "until the sustainability of the business model is firmly established". This phrase could potentially be read as imposing distribution restrictions which do not have a legal basis. The concepts of "badwill distribution" and "sustainability of the business model" are generally too vague in our opinion to be applied in a consistent manner in this context. We suggest instead that the ECB clarify that badwill is not to be considered as windfall profit which can be immediately distributed, and that existing ECB distribution recommendations will otherwise apply.

We have similar concerns with paragraph 33 as badwill cannot be "used" but is simply the difference between the accounting values on which prudential requirements are based and market valuations and is a portion of the capital of the acquired entity on a standalone basis.

9. **Internal models [section 3.4, paragraphs 34-36]**

We generally welcome the flexibility the ECB is providing with respect to allowing for a temporary period, and subject to a credible role out plan, during which internal models in place before a merger can continue to be used. In order to ensure the roll-out plan is successfully completed, we would invite the ECB to consider the need to prioritise and adapt the planning of any new internal model investigations required accordingly. We would also like to make some more specific suggestions which could contribute to an efficient implementation of the roll-out plan. To the extent that this may require temporary waivers from the EBA's PD & LGD Estimation Guidelines, and potentially discrete adaptations of the CRR level 1 text, we would invite the ECB to flag and discuss these within the relevant regulatory for a in so far as they would be appropriate for facilitating M&As.

- We would welcome guidance from the ECB in this section of the final guide on how the integration of historical data of an acquired entity into the IT infrastructure of the buyer should be prioritised. For example, the focus could initially be on the integration of most recent data, and a longer time frame (e.g. 5 years) given for the integration of older data. In parallel, associated Margins of Conservatism (MoCs) should be reviewed and, if necessary, temporarily adjusted so that action plans do not unintentionally negate the potential viability of the integration exercise.

- This would require the ECB to consider how to facilitate the implementation of the required representative analysis in Chapter 4.2.2 of the EBA's PD and LGD Estimation Guidelines in the cases of M&A transactions, with the focus being first on the most recent data (e.g. 1-2 years) and potential temporary relief of MoCs.

- For the calibration of AIRB parameters which will be applied to consolidated portfolios, while a joint parameter calibration could be an option, to avoid a buyer's internal models being unduly impacted by the historical behaviour of the acquired portfolio, a specific parameter could be developed for the acquired portfolio with a phase-in to joint calibration (e.g. after 5 years). Where the acquired bank's portfolio is not representative, this could be subject to a run-off.

Finally, we would also welcome clarification in guide as to the roll-out flexibility which may be allowed when a third country acquirer would purchase an SSM SI and intends to roll-out its internal models within the SSM entity. We would encourage close coordination between the ECB and the ultimate home authority of the group in this respect.

10. Enhanced monitoring of execution risks [section 4.1, paragraphs 37-40]

The ECB envisages applying a high level of scrutiny in overseeing the business combination integration plan. Whilst firms will seek to submit integration plans with the highest level of accuracy and completeness, it is often the case that plans will be subject to change – unforeseen conditions (internal or external) may arise which may require firms to adjust their integration plans (for example, COVID-19).

The ECB might consider provision for more flexibility for firms to meet the milestones in their integration plans. Firms would not want to allocate a disproportionate amount of time to consulting with and seeking approval from the ECB in adjusting their plans when the adjustments could have immaterial impact to the business combination – which should be measured on an outcomes basis.

The ECB should also consider proportionality in undertaking its monitoring mandate. If the size of the target is very small compared to the buyer and/or the buyer group and is equally not significant for the market, the ECB might consider a more proportionate approach compared to one involving a more significant acquisition for the buyer firm, its group and/or the market. The parameters of an acquisition which would merit a lighter level of scrutiny should be clearly defined by the ECB.

B. Elements not included in the guide and which should be addressed in the final version

1. Coordinating the determination of requirements involving multiple authorities in a cross-border context

AFME considers that the ECB could play an important role in supporting consolidation, and cross-border consolidation in particular, by expressing in the final guide the intention to facilitate the recognition of the Banking Union as a single jurisdiction where possible within the current legislative framework. In practice, this could include coordinating actions with other relevant authorities such as Designated Authorities, for instance in the context of the additional

EU G-SII methodology set out in CRD5 Art 131, or by coordinating the scoring and bucketing approaches for setting D-SII buffers and, where relevant ensuring they are aligned with any G-SII buffer. Greater coordination with NCAs (including outside of the SSM) in the context of cross-border liquidity waivers would also be helpful and, as noted above, we encourage the ECB to update and publish its approach to cross-border liquidity waivers.

2. Commitment to coordinate and accelerate authorisation procedures

Streamlined, harmonised, integrated and clear authorisation process will be particularly important when firms are executing M&A projects. Confusion over the process could result in delays in the execution of such projects, and there could be wider impacts if processes are unduly complex – as firms will also need to manage relationships with various internal and external stakeholders (such as employees, clients and suppliers). We understand, for instance from the July stakeholder engagement on the present draft Guide, that the ECB's intention is to assist firms in navigating and by coordinating these processes, at least to the extent that the decision-making power lies with ECB Banking Supervision.

We would very much welcome an explicit recognition of this coordinating role in the Guide, including if possible more details on the approach or role the ECB would be able to adopt when decision-making would also involve NCAs (for instance if the transaction would involve an LSI or other entity not subject to direct ECB supervision) as well as third country supervisory authorities. We also suggest that authorisation processes could be simplified where the ultimate controlling entity does not change (for instance in cases when legal entities structures within a broader group are re-organised) and that specific, fast-track procedures be put in place when the acquired entity is an entity in resolution . Finally, in order to reduce execution risk, especially for transactions where an acquisition involves listed entities (e.g. in case of public tender offers) it would be useful to reduce the time necessary to complete all the authorisation process for all the various relevant authorities and to have well-established timelines to which all parties adhere. The ECB could leverage the work it is carrying out to build an "authorisation portal" to this effect.

In the interim, it would be extremely helpful if the ECB could publish, perhaps as an addendum to the final guide, the relevant processes/steps for qualifying holdings (drawing on the information already published on its website) together with the relevant steps (and contact points) required under national laws for business combination authorisations.

3. Deploy flexibility to allow post-combination capital restructuring when required

As mentioned above in Section A of our response, the non-inclusion of surplus capital pertaining to minority interests in consolidated own funds represents a substantial impediment to M&A. Minority interest "haircuts" can be significant By way of example, when the EBA clarified that AT1/T2 instruments issued by bank operating companies would be subject to a haircut at the bank holding level in November 2017 (see EBA Q&A 2017_3329), several banks reported a significant impact on their own funds. For instance, at year-end 2017, AIB and Bank of Ireland reported decreases of their capital ratios by 95bp and 140bp respectively, while for ABN Amro, the drop was much more pronounced (-5.4%).

More generally, given that AT1 and Tier 2 instruments can typically represent around a quarter of a bank's regulatory capital mix (in the case of 12% CET1, 4% AT1/Tier 2), and that banks often hold at least excess capital in the region of 2%, the minority interest haircut on AT1/T2 capital (assuming 100% of the CET1 is purchased by the acquiree), calculated as the proportion of AT1/Tier 2 in the capital structure multiplied by the excess capital, would represent at least 0.5% of RWAs.

For example, when Clydesdale Bank acquired Virgin Money in 2019, the AT1 instrument issued out of the Virgin Money Holding company would have been subject to minority interest haircuts at the Clydesdale Group level, and potentially would have been fully derecognised if Virgin Money Holding UK plc ceased to be an intermediate holding company. As a result, before the acquisition was finalised, Clydesdale had to undertake a consent solicitation on the Virgin Money AT1, to substitute the issuing entity to Clydesdale Bank.

As these examples show, the current regulatory framework for minority interests directly impacts banking consolidation.

The SSM may wish to consider whether it can use its supervisory powers within the existing regulatory framework to alleviate this, assuming that the appropriate conditions on the loss-absorbing nature of the surplus capital are confirmed.

For instance, during the assessment process, the SSM could consider an adjustment of the capital requirement of the acquired entity to allow for the full inclusion of AT1 and T2 in the consolidated own funds. This could be considered as a pragmatic approach aimed at alleviating the undesirable consequences of the minority interest haircut. However, for the avoidance of doubt, to the extent that such an increase in the "pro-forma" capital requirements of the acquired entity would not reflect increased risks, it should not increase the final capital requirements at consolidated level, nor at the legal entity or, sub-consolidated levels. We also recall our general point that P2R and P2G should only apply at the highest level of consolidation within the Banking Union.

The ECB could also examine whether it could make greater use in practice of the existing waiver of the minority interest haircut foreseen in CRR Art 84.5.

Alternatively, the ECB could explicitly note in the guide that acquiring banks will be given flexibility on repurchases of such capital instruments, by allowing them to be repurchased within 5 years of the issuance date, on the basis that M&A activity would constitute exceptional circumstances (and therefore be allowed under article 78(4)(d) of the CRR). This will allow banks to conduct open market repurchases of instruments issued out of subsidiaries and replace them with instruments issued from the parent entity. This could be particularly helpful in situations where consent solicitations to substitute the issuer would not be practical or possible.

Similar considerations are also relevant for MREL requirements, where the resolution strategy of the group may also need to be adapted to facilitate, or following, an acquisition. Currently, regulations do not specify precisely what process should be followed in the event of an acquisition, and fail to accommodate for the likely need to transition from separate resolution strategies and plans to one tailored to the group as it exists post-acquisition.

In case of an M&A transaction, the outstanding stock of MREL eligible liabilities issued out of the target company may no longer be MREL eligible, for instance because they are no longer issued from a resolution entity, and external MREL may need to be replaced with internal MREL, depending upon the resolution strategy for the group following the transaction. Time will therefore be needed for the Resolution Authority to produce a new resolution plan, which itself would entail updated MREL targets for the post-acquisition group. An appropriate implementation period should therefore be provided for any changes to MREL (or other aspects of resolution planning).

As a part of the envisaged transition, liability management exercises may need to be undertaken in order adapt the MREL structure to the new group resolution plan. For example, this could involve the need to repurchase or redeem existing MREL issuances of the target and issue new eligible liabilities out of the acquirer. This would likely be a significant exercise and would require a certain period of time to fully perform the transition. Any acceleration of such a procedure could jeopardize the transactions and, in any event, would remain subject to market conditions. While MREL decisions rest with the resolution authority rather than the ECB, confirmation that an appropriate period will be provided for any necessary restructuring of external and internal MREL following the completion of the transaction would reduce this obstacle.

The guide confirms, in paragraph 29, the ECB Banking Supervision's intention to coordinate with the SRB. We encourage consideration of issues such as the above in this context, with a view to facilitating assessment of the resolvability of the combined entity and the determination of the MREL where the resolution strategy of the group could be adapted to facilitate an acquisition.

4. Supervision of the post-merger entity

The guide is currently silent on the way the supervisory programme for the newly formed entity will be conceived. To the extent that the ECB considers it to be appropriate with regards the risks of the new entity, we suggest that the post transaction SEP could be focussed on the execution of the integration and should not be a "simple sum" of the previous entities' programmes. We would welcome clarification in the guide that the newly formed entity will receive a revised SEP, including an adjusted OSI schedule, taking into account the revised supervisory priorities for the new entity along the above lines.

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About AFME

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